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C O N F I D E N T I A L SECTION 01 OF 03 BEIJING 002144

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TAGS: [PREL](#) [PGOV](#) [ECON](#) [EINV](#) [CH](#) [AS](#)
SUBJECT: (C) AUSTRALIAN AMBASSADOR CONFIRMS GOA SURPRISE
OVER RIO TINTO DETENTIONS BUT SEES NO LINK TO CHINALCO

REF: A. SHANGHAI 321
[1](#)B. BEIJING 0151

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Classified By: Robert Goldberg, Charge d'Affaires, a.i.
REASON: 1.4 (b)

[1](#)1. (C) Summary. China's recent detention of Australian citizen Stern Hu and three other Rio Tinto executives surprised the Australian government, according to Dr. Geoff Raby, Australia's Ambassador here. Raby told the Charge July 24 that his government had seen no evidence of bribery, espionage or anything else that would justify the arrests. Contrary to media speculation that the arrests might be retaliation for the failed Chinalco-Rio Tinto deal, Raby and many in the government and business communities viewed the situation as part of a broader effort by the Chinese government to regain control over the Chinese steel industry and crack down on individual negotiations between Chinese steel companies and the major iron ore miners. He asserted that Stern Hu and the others detained were victims of a larger problem arising from China's overly broad definition of "state secrets." Despite Australian and PRC efforts to keep the Rio Tinto issue from affecting the two countries' larger bilateral relationship, Ambassador Raby said the Stern Hu case will likely be difficult to manage in the long term. He confirmed that West Australian Premier Colin Barnett had raised the Rio Tinto issue in meetings with Chinese counterparts during his trade visit to China. Australian FM Stephen Smith had also raised the issue with Chinese FM Yang Jiechi on the margins of regional security meetings in Phuket, Thailand, but Raby did not have a readout of the conversation. Raby categorized overall relations between Australia and the PRC as being surprisingly positive before the Rio Tinto controversy. End summary.

Stern Hu situation is a mess and took us by surprise.

[1](#)2. (C) Ambassador Raby categorized the situation surrounding China's recent arrests of Australian citizen Stern Hu and three other Rio Tinto executives as a "complete mess" that took the Australians by surprise. The saga started on July 5th when Hu's wife placed a call

to the Australian consulate informing them that Hu had been taken into custody by officers from the Shanghai Bureau of State Security (SBSS). Since then, Raby said, PRC officials have followed the bilateral consular agreement to the letter, allowing Australian consular officials one visit with Hu thus far (Ref A). While Australian officials originally interpreted the allegations against Mr. Hu as "espionage," PRC officials later clarified that Mr. Hu was accused of "illegally obtaining state secrets." Raby said he was still unclear as to how the two charges differ. SBSS officials have confirmed that Hu can be denied legal representation for up to 30 days, during the investigatory phase of the case. Raby confirmed that Hu had not been able to provide any helpful information related to his case during his visit with Australian consular officials.

13. (C) Raby noted that Australia appreciates the USG's support in the Rio Tinto case and asked for details of comments U.S. officials had made on the case during their recent visits to Beijing. Australian Embassy officials also requested advice from U.S. consular officials, noting their lack of experience with similar cases of this nature.

GoA sees no evidence of bribery in Rio Tinto case.

14. (C) Ambassador Raby stressed that he had seen no evidence thus far to suggest that Hu was involved in any activities that could be considered other than normal for commercial negotiations. Raby said Rio Tinto denied the bribery allegations and claimed that internal auditing controls limit any possibility for the types of bribes Hu

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is accused of making. There simply wouldn't be any cash available to make such illicit deals, he stressed.

15. (C) Raby noted it was not uncommon for companies like Rio Tinto to share information with the GoA, including that related to commercial negotiations. Raby asserted, however, that following a careful review of the record, it appeared that all the negotiation-related materials Hu had obtained were in the public record. He noted that the most sensitive piece of information Rio had obtained was the fact that the China Iron & Steel Association (CISA) was aiming to negotiate a 47 percent price reduction with the major iron ore suppliers, rather than the 33 percent reduction agreed to by Japanese and Korean steel mills. Raby indicated that as a result of CISA's tendency to negotiate in public, this information was widely reported in the press and well-known to anyone involved in the negotiations. He added that in going through the information Rio Tinto had shared with the GoA, Australian Embassy officials noted an unmarked document sent from Hu's Gmail account that had apparently come from CISA. The document, however, did not appear to contain information that would be considered a state secret by international standards.

CISA tries to gain control over China's steel industry

16. (C) In response to CDA Goldberg's query as to whether Australia views the Rio Tinto arrests as retaliation for Rio's recent failed deal with Chinalco, Ambassador Raby said they saw no relation between the two. He confirmed that Chinalco was once again in preliminary talks with the GoA regarding Chinese investment in new mineral projects and that West Australian Premier Colin Barnett had met Chinalco Chairman Xiong Weiping earlier in the week during a visit to China.

17. (C) Instead, Raby said he viewed the Rio Tinto arrests

as part of a broader effort by CISA to regain control over the annual iron ore negotiations and re-centralize the Chinese steel industry (Ref B). He asserted that CISA counts on the annual iron ore negotiations to remain relevant but that individual Chinese steel mills have increasingly been negotiating independently with Rio and the other major iron ore suppliers. Raby said the new head of CISA wants to crack down on the practice of China's steel mills negotiating separately so it can unite China's negotiating position and maximize China's bargaining power in annual iron ore negotiations. At the same time, the PRC needs to drive down iron ore prices to alleviate cost pressures the large, state-owned steel mills are facing. Raby argued that China's major steel mills are highly unprofitable, referring to his visit to one large steel mill that appeared to be almost completely automated while managers claimed it employed over 100,000 people. He pointed out that since the Chinese government will not allow the large steel mills to lay off workers, the mills have engaged in selling contracted iron on the spot market to help prop up profitability and maintain excess employment levels. The Chinese government, Raby said, thus faces a difficult issue, i.e. how to prop up the unprofitable steel SOEs while at the same time taking away their ability to make money by selling contracted iron ore to smaller players.

18. (C) Ambassador Raby pointed out that Rio Tinto had also been profiting from spot market sales of contracted iron ore by capitalizing on the 10 percent margin of variability in delivery volumes that is allowed in its contracts. While the Chinese viewed this margin as flexibility to account for variations in shipments, Rio Tinto had been using this contract provision to withhold 10 percent of its contracted ore to sell at much higher prices on the spot market. Raby said this practice had long angered the PRC government.

Few jarring moments in Australia-PRC relations

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19. (C) Prior to the controversy surrounding the Rio Tinto arrests, relations between Australia and the PRC had been on a surprisingly positive track, Raby said, with only a few "jarring moments" of late. One recent moment arose from a statement Australian PM Rudd made in parliament shortly after Secretary Clinton's remarks on the June 4th anniversary of the Tiananmen Square crackdown. (Comment: Embassy has not seen Rudd's statement. End comment.) Raby noted that when PRC officials brought up Rudd's comments, Australian Embassy officials simply said Rudd was supporting the U.S. view. Raby added that West Australian Premier Colin Barnett's trade visit to China had gone well, except when, during a July 23rd meeting, NDRC Chairman Zhang Ping blamed the failed Chinalco-Rio Tinto deal on Australian government interference and the misgivings of Rio Tinto shareholders. PRC officials were also "irate" about Uighur activist Rabiya Kadeer's planned visit to Australia. However, Raby noted he had only been called in once by MFA to discuss matters relating to the recent unrest in Xinjiang.

PRC pre-briefs limit blowback on Defense White Paper

110. (C) CDA Goldberg noted that the Australian Defense White Paper, published earlier this year, expressed a high degree of concern about China and asked if Australia had received any blowback from the PRC on the document. Ambassador Raby said there had been almost none. He added that the paper was written in very conditional terms,

and its author had briefed the Chinese PLA and MFA before
the paper went public, mitigating the Chinese response.

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